The City of Lincoln Nebraska

Police and Fire Pension System

Plan C

Deferred Retirement Option Plan - DROP

Administered by the

City - County Personnel Department

Lincoln, Nebraska 68508

Telephone Number (402) 441-7517

Police & Fire

Pension Plan

I. INTRODUCTION

This brochure has been prepared to assist you in understanding the provisions of the City of Lincoln Nebraska Police and Fire Pension **D**eferred **R**etirement **O**ption **P**lan, or **DROP,** and if DROP participation might be beneficial for you. In the event the information contained in this brochure conflicts with the DROP Ordinance or federal law, the language in the DROP Ordinance and the federal law shall be the final authority.

The DROP will allow members to have their monthly retirement benefits deposited to their DROP account, earning interest, while simultaneously continuing to work (but not earning additional credit for retirement). The member would choose how to invest the money in his or her DROP account. At the end of five years, or anytime before five years, the member must “retire-in-fact.” When the member retires-in-fact, his or her monthly pension benefit will be paid directly to the member (not the member’s DROP account) and the member will have access to the money in his or her DROP account.

The purpose of this program is to provide a way for members to accumulate additional savings while continuing employment. Similar programs have been implemented by other state and local governments. Originally popular with Police and Fire Plans, DROPs now exist for teachers and general public employees as well.

There is no rigid structure that must be followed for DROP programs. The design of DROP programs varies greatly and they are usually crafted to meet the needs of each group of employees and their employer. A DROP program is simply another distribution option within a traditional defined benefit pension plan. It is not a separate qualified retirement plan.

The DROP became effective for Police and Fire Pension Members on October 1, 2001 following passage by the City Council and approval from the Internal Revenue Service.

> DROP programs are not formally reflected in federal pension laws and regulations. As a consequence, the pension applied for a favorable determination letter to the Internal Revenue Service - to review the proposed DROP program and render an assessment as to whether the program complies with federal regulations and therefore would not adversely impact the qualified status of the pension plan.

II. ELIGIBILITY

All Members of the Police and Fire Pension are eligible to participate in the DROP when they become eligible for normal age and service retirement. For members in Plan C, normal age and service retirement requires the member to attain both age 53 and 21 years of service. Plan C members can enter the DROP up to one year after becoming eligible.

There is a grandfather provision for DROP eligibility. Any Plan C member who has attained both age 53 and 21 years of service before the DROP became effective can enter the DROP up to one year after the DROP's effective date, ie. until October 1, 2002.

III. DROP ENROLLMENT

Any eligible member may enroll in DROP by completing the necessary forms during an appointment with Pension Administration.

If desired, the member may instruct pension administration to transfer his or her accumulated pension contributions and interest to the member's DROP account. If this transfer is requested a DROP account is created for the member specifically for these funds and their earnings. This "Lump-sum" DROP account is kept separate from the "Monthly Benefit" DROP account into which the member's monthly pension payments and earnings are contained. When the member directs how the assets in the two separate DROP accounts are invested, the accounts will appear as if they are one account. However, details of each separate account will also be available. These funds are kept separate just in case a separate accounting for each is ever necessary for tax purposes.

If the member does not desire a transfer of his of her accumulated pension contributions and interest to his or her DROP account, the member designates a beneficiary(s) to receive the full amount of his or her accumulated pension contributions and interest should the member pass away during participation in DROP.

The member also chooses a payment option for his or her monthly pension; Straight Life, 100% Survivor or 50% Survivor, and designates a pension beneficiary if a survivorship option was chosen. If the member chose to transfer his or her accumulated pension contributions and interest to the member's "Lump-sum" DROP account, the monthly payment is actuarially reduced by the amount of the transfer.

The member's pension benefit is determined at the time of DROP enrollment and will not be increased due to salary raises, promotions, increased years of service or pension enhancements.

The member signs an acknowledgment form stating they understand the DROP and agree to "Retire-in-fact" within the next five years. The member chooses how to invest their DROP assets and designates primary and contingent beneficiary(s) for his or her DROP account.

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Pension administration changes the member's contribution rate to 0%.

A DROP account is established for the member, to hold the monthly pension benefit deposits and earned interest.

IV. DURING DROP PARTICIPATION

The member may change the person(s) designated as beneficiary to receive his or her accumulated pension contributions and interest at any time during the DROP period.

The member continues actively working and receiving a check every two weeks. The member retains his or her employment rights, privileges and benefits.

The member's pension benefit is deposited into his or her DROP account on the last working day of each month. When eligible to receive a 13th Check COLA payment, it is deposited into the member's DROP account. All pension benefits are paid into the member's account on a tax-deferred basis. Also, depending on the investment alternatives selected by the member, his or her DROP account may earn tax-deferred interest, dividends and capital gains.

> The Pension Plan has applied for and received a favorable letter of determination from the IRS to ensure the DROP program will not jeopardize the tax-qualified status of the pension plan. Qualification of the plan under 401(a) of the Internal Revenue Code assures that DROP participants are not subject to constructive receipt of income under the plan with respect to DROP benefits prior to actual distribution of DROP benefits accrued under the Plan. Pursuant to 401(a), DROP participants, as members of a Qualified Plan, would not be subject to constructive receipt of income prior to actual distribution.

The assets of the DROP are considered Pension assets and are therefore not taxable until the member receives them. The member self-directs how his or her DROP account is invested from mutual funds offered by SMITH HAYES Financial Services and can change how his or her funds are invested by contacting SMITH HAYES either by telephone or internet site. The member may also change the person(s) designated as primary and contingent beneficiary(s) for his or her DROP account at any time during the DROP period.

A member may stop working (ie. "retire-in-fact"), or the City may terminate the member's employment in the same manner as before DROP participation.

If the member is determined to suffer a duty related death during the DROP period, the member's pension survivor beneficiary (pension beneficiary will take precedence over DROP beneficiary if they are different people) will have the choice of forfeiting the member's DROP account and accepting a duty death pension, or allowing the member's DROP account arrangement and forgoing a duty death pension.

If the member is determined to suffer a non-duty related death during the DROP period, the member's employment will cease as of the date of his or her death. The member's DROP account and pension benefits will be paid according to the member's instructions.

The member may apply for a duty related disability. If the duty disability is granted the member must forfeit his or her DROP account arrangement and accept a duty disability pension.

If the member incurrs a non-duty related disability during the DROP period, the member will NOT be allowed to apply for non-duty disability pension benefits. The member's DROP account and pension benefits will be paid according to the member's prior instructions as if the member had 'retired-in-fact' on the date of his or her non-duty disability determination, or last working day.

V. DROP EXIT ie. "RETIREMENT-IN-FACT"

The member should notify pension administration and his or her department of their intent to "retire-in-fact" two weeks prior to actual retirement.

The member exits DROP by completing the necessary forms during an appointment with Pension Administration. The pension payment option and amount chosen by the member at the time of DROP enrollment will continue during retirement. If the member did not transfer his or her accumulated pension contributions and interest to his or her DROP account, the member must redesignate a beneficiary to receive his or her remaining pension contributions and interest. Please refer to the Return of Account Value section of the Description of Plan "C" Benefits brochure for details on this pension feature.

The member will be asked to complete a W-4P tax withholding form, a health and life insurance election form and a direct deposit form. The member will also need to decide how he or she wishes to receive his or her DROP assets.

Pension administration will notify SMITH HAYES Financial Services of the members retirement, thereby allowing the member access to his or her DROP account assets.

VI. DURING ACTUAL RETIREMENT

Regarding the member's pension benefit:: The member's pension benefit is paid directly to the member, (not the member's DROP account) or direct deposited into his or her bank account. Depending on the member's instructions, deductions for tax withholding, health and life insurance are taken from the member's monthly pension benefit. In January of each year pension administration mails a Internal Revenue Service 1099-R form totaling benefits paid and taxes withheld.

Regarding the member's DROP account: The member may choose from the following:

a. Receive a Full Lump Sum refund of the entire DROP account less taxes.
b. Receive a Direct Rollover wherein the funds are paid directly to the member's IRA or the custodian of an eligible retirement plan as defined in the Internal Revenue Code.
c. Receive a Partial Lump Sum refund and a Direct Rollover B A combination of the first two options, the proportion is up to you.

The member's choice must comply with Internal Revenue Code (IRC) 401 (a)(9). IRC 401 (a)(9) states a member must begin taking money out of a tax deferred retirement account, like an IRA or a DROP, by April 1st of the year following the calendar year in which the member attains age 70 ½ unless the member is still working. If the member is still working and participating in a qualified plan he or she may postpone withdrawals until terminating employment.

The law states rollovers must be paid directly to the custodian of an eligible retirement plan as defined in the Internal Revenue Code. Eligible retirement plans include an individual retirement account (IRA), an individual retirement annuity, a qualified trust, or an annuity plan. If the member passes away, his or her DROP beneficiary will only be eligible to rollover DROP benefits into an individual retirement account or an individual retirement annuity.

If the member authorizes SMITH HAYES Financial Services to transfer the lump sum value of his or her DROP account directly to an IRA or qualified retirement plan, there will be no immediate recognition of income for purposes of federal income taxation. The member would pay taxes on these funds only as funds are received from his or her IRA or qualified retirement plan.

However, in the event that the member does not choose a direct rollover of any portion of his or her DROP account that is an Aeligible rollover distribution≅, the payment is taxed in the year the member receives it. The following rules would generally apply:

1. The distribution will be treated as a source of ordinary income to the member (and taxed accordingly) in the year the member receives it.

2. The member will be subject to the 10% Aearly distribution≅ tax penalty rules if he or she is less than 55 years old.

3. The member may be subject to a 15% Aexcess distribution≅ tax penalty if his or her total retirement proceeds (from the DROP account, any IRA=s or qualified retirement plans) exceed the IRS maximum distribution amount for the year in which he or she received the distribution.

This is our understanding of the current tax issues. We may not be correct. We are not allowed to give tax advice in any way. Keep in mind the **tax laws can change,** and they are complex. We **recommend and encourage** you to seek the advice of a tax professional to determine what is best for you and how you will be impacted.

VII. ADDITIONAL DROP CONSIDERATIONS

HOW COULD A DIVORCE AFFECT A MEMBER'S DROP ACCOUNT?

DROP assets, like other forms of pension benefits, are considered marital property subject to division in a divorce proceeding. As plan assets, DROP assets are not subject to distribution until a member terminates employment with the City. A court can determine that upon distribution, a certain percentage of the DROP assets be awarded to a former spouse in the same manner as other retirement payments.

A Qualified Domestic Relations Order (QDRO) is a court order issued pursuant to divorce proceedings. A QDRO relates to the provision of child support, alimony payments, or marital property rights to a spouse, child, or other dependent of a member. Governmental plans, like the Police and Fire Pension, are not subject to QDRO=s. However, the pension plan will try to accommodate the provisions of a QDRO as long as they do not require payment or asset segregation not otherwise stipulated in the pension ordinance. When constructing a QDRO member's are advised to work with pension administration regarding DROP and pension assets. Divorce laws can be quite complex. Therefore, you may wish to speak to legal counsel to discuss your personal circumstances.

WHEN SHOULD I ENTER THE DROP?

This is a very personal decision. No one knows better than you when to begin taking retirement benefits. In other words, before entering the DROP, some careful financial planning is in order.

If the Plan benefits change after you DROP, those benefits will not be available to you. If you get a raise or a promotion after you enter the DROP, that salary increase will not count toward your pension. Once you DROP, you are retired under the Pension Plan. Your benefits are fixed and will not change.

WHAT ARE SOME ADVANTAGES OF DROPS?

A DROP program can be very advantageous to a member who is interested in assembling a Anest egg≅ for themselves and their family and providing a Ajump-start≅ into retirement. This Anest egg≅ can offer the member the ability to start a business, purchase a home, travel, etc., upon retirement.

The DROP program allows the member to select an option that would effectively accelerate a portion of the retirement benefits that would otherwise have been received over an extended period of time. If the member has reason to believe that his or her life expectancy will be less than average, the DROP could be viewed as a practical response to this outlook.

Other advantages are:

- Receive pay from active employment and pension at the same time.
- Self directed asset account(s).
- Lump sum distribution.
- Tax deferred earnings.
- Retention of all employment rights, privileges and benefits during DROP period.

WHAT ARE SOME DISADVANTAGES OF DROPS?

One disadvantage of participating in a DROP plan is that the amount of monthly pension a member receives will be lower than the amount the member would receive under a normal retirement calculation performed at the time of actual retirement.

Another disadvantage is that the decision to enter the DROP is irrevocable. A member could change their mind about actual retirement, but once they have entered the DROP, they are not allowed to reverse the decision to retire. A DROP member experiencing the birth of a child, a new marriage, divorce, or other significant life event, has no choice but to retire at the end of the DROP period.

ARE ESTIMATES OF DROP ACCOUNT BALANCES AVAILABLE?

Yes. A member who desires additional financial information concerning DROP may:

- Request a non-binding written estimate of his or her regular age and service pension benefit based on estimated years of service and compensation as of the proposed DROP participation date and a non-binding written estimate(s) of his or her DROP account. For the DROP account estimate the member may choose a hypothetical interest rate and DROP duration less than or equal to five years. The non-binding written estimates will be mailed to the member's residence.

- Schedule an appointment with the Pension's administrative office to discuss DROP, during which the non-binding written estimates described above can be reviewed.

- Schedule an appointment with a representative of SMITH HAYES Financial Services to discuss DROP and investing. If the member wants to discuss any individualized figures, such as those produced in the non-binding estimates, the member will need to bring such data to the appointment.

VIII. HOW TO ENROLL IN DROP

A member who desires to participate in DROP must schedule an appointment to meet with a representative of Pension Administration to complete forms at least one week prior to the member's starting date of participation in DROP.

A. Plan C Election Form: The Member must select a DROP Entry Date, whether to transfer his or her accumulated pension contributions and interest to the DROP, and select a pension payment option. If applicable, the member can designate a Pension Monthly Payment Beneficiary and Pension Contributions and Interest Beneficiary. The Member can not change his or her Pension Monthly Payment Beneficiary after monthly payments have started, but can change his or her Pension Contributions and Interest Beneficiary at any time.

   - Pension Monthly Payment Beneficiary: The person chosen by the member to receive survivor benefits payable from the Pension. The member has three choices regarding Pension Payment Types: Straight Life, 100% Survivor and 50% Survivor. If the member chooses the 100% survivor or 50% survivor payment type he or she must choose a Pension Monthly Payment Beneficiary. After the member's death, if the Pension Monthly Payment Beneficiary is still living, they will receive survivor benefits payable from the Pension for the remainder of their lifetime.

   - Pension Contributions and Interest Beneficiary: The Person(s) chosen by the member to receive the member's accumulated contributions and interest (as of his or her DROP entry date) if the member passes away while participating in DROP.

B. Acknowledgement Form: Statements regarding the DROP plan are listed. By signing this form the member states he or she understands DROP and agrees to participate.

C. DROP Account Investment Selection Form: This form lists the DROP account investment alternatives. The Member will use this form to instruct the pension regarding the initial investment of his or her DROP deposits. The member will select the investment alternative(s) he or she wishes to use and the percentage of his or her DROP payment to be deposited into each selected investment alternative.

D. DROP Account Beneficiary Designation Form: The member can designate Primary Beneficiary(s) and Contingent Beneficiary(s) to receive his or her DROP account assets. The Member can change this designation at any time by filing a new DROP Account Beneficiary Designation Form with the Pension's administrative office.

   - A designated beneficiary will receive the DROP account only if the Member dies before receiving his or her entire DROP account balance. In the event the Member fails to designate a beneficiary, the member's spouse defaults as primary beneficiary, and the member's dependent child(ren) default as contingent beneficiaries. If the Member fails to designate a beneficiary and has no spouse or dependent child(ren) at the time of his or her death, the member's estate will receive the DROP account balance remaining unpaid at the Member's death.

Copies of the forms are shown on the following pages.

Form Plan C Election

DROP Acknowledgement Form

DROP Account Investment Selection Form:

DROP Account Beneficiary Designation Form